INTERNAL AUDIT EFFECTIVENESS: RELEVANT DRIVERS OF AUDITEES SATISFACTION

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MOTIVATIONS AND RESEARCH OBJECTIVE

In recent years, researchers and practitioners have widely discussed the need for internal auditors of adding more value to their companies operations, and contributing to the achievement of corporate objectives. This new perspective has focused increasing attention on issues such as performance evaluation and effectiveness of internal auditing (for instance Dittenhofer, 2001; Bou-Raad, 2000; IIA, 1999). Several parties advocated the need to assess internal auditing (IA) effectiveness, though, at present, there is not a shared framework of reference to this scope (for instance Ridley & D'Silva, 2008; Mihret & Yismaw, 2007; Van Gansberghe, 2005; KPMG, 2004; Dittenhofer, 2001; Sawyer, 1995; Barrett, 1986). Recently, Sarens (2009) have raised the question "when can we talk about an effective IA function?" in his editorial about future perspectives of IA research. Looking at the existing literature, there are many possible answers to this question. Different authors have related IA effectiveness to different issues, focusing on IA processes, outputs and outcomes.

Certain authors related IA effectiveness with the quality of IA procedures, such as the level of compliance with IIA standards or the ability to plan, execute and communicate audit findings (for instance Fadzil et al., 2005; Xiangdong, 1997; Spraakman, 1997). However, this approach suffers from a major limitation as it is based on the hypothesis that IA activity is effective if IA procedures are carried out properly, without considering the needs of the main stakeholders in each individual audit (Lampe & Sutton, 1994). This is in contrast with the current trend that stresses the relevance of value-added activities and indicates stakeholders' satisfaction as one of the critical performance categories for IA activities (see, for instance, the Practice Advisory 1311-2).

A second stream of research relates IA effectiveness to the output of IA activities (Frigo, 2002), looking for instance at the ability of IA to respond to auditees' needs (see, for instance, Frigo, 2002; Ziegenfuss, 2000; Barrett, 1986). In this context, a recent work by Ziegenfuss (2000) has highlighted that the survey results of auditee satisfaction and the percent of recommendations that are implemented are the performance measures considered by the CAE to be most suitable to evaluate IA effectiveness.

Finally, a few authors went further, relating IA effectiveness to the outcome of the audit activities (i.e. the impact of a certain output of the audit process). According to Dittenhofer (2001), "when evaluating the effectiveness of the internal auditing operation, a positive response would be given when the internal auditor: (1) audits the achievement of the auditees' objectives and finds no problems, and no problems surface following the audit; or (2) audits and finds problems; and (3) recommends solutions to the problems; *and* the *solutions resolve the problems*". From this statement it is clear that outcomes address a wide range of aspects, i.e. all the elements on which audit activities have an impact. These include both efficiency and effectiveness of the audited processes, and corporate performances. At a process level, for example, the impact of IA activities has been related to cost savings generated by the implementation of suggested recommendations (see, for instance, Cashell and Aldhizer III, 2002). At a corporate level, outcome can address the IA contribution to corporate performance, such as profit, growth, or share price; or its role in the avoidance of corporate failures by ensuring sound corporate governance. This last issue has been given particular attention in the most recent literature. Sarens (2009), based on Gramling et al. (2004), suggested that IA can be considered effective when the quality of IA function "has a positive impact on the quality of corporate governance". He also goes on linking IA quality to the "capacity to *monitor* and *improve* risk management and internal control processes".

In our opinion, this is a key point. In fact, to *improve* risk management and internal control processes, the internal auditors have to convince the auditees about the quality of their work, persuading managers to implement their recommendations. The internal auditors, in most of cases, do not act on the internal control-risk management system "directly". They can identify a criticism or an area of potential improvement and provide managers, responsible of business processes, with an evaluation of the internal control–risk management system. Then, managers and officers have to decide whether and how enacting internal auditors' recommendations. As highlighted by Mihret and Yismaw (2007), audit findings and recommendations would not serve much purpose unless management is committed to implement them. Implementation of audit recommendations is therefore highly relevant to audit effectiveness (Van Gansberghe, 2005; Sawyer, 1995). The effect that internal auditors have on the achievement of corporate objectives (i.e. their effectiveness) is influenced by the extent to which managers consider internal auditors' work valuable and decide to exploit it. In such view, the effectiveness of IA depends on the *quality perceived* by the auditees.

Given the central role of auditees' perceptions in relation to IA effectiveness, this paper aims at analysing which factors can influence the quality perceived by managers and can enhance auditees' satisfaction over internal auditors' contribution.

CONCEPTUAL MODEL

To investigate which factors can influence the quality perceived by managers we relied on a conceptual model drawn from the literature. The model tackles three sets of issues which could influence IA effectiveness; two of them deal closely with internal auditing (Sarens, 2009), and the last one deals with the organization as a whole. They are:

(1) the characteristics of the IA units;

(2) the characteristics of individual internal auditors working in the IA units.

(3) the organizational environment.

	Organizational environment		
Firm	Regulatory context		
	Level of risk of the industry / business		
	Internal Audit units		
Staff and position	Size		
	Intensity of relationship with top management		
	Intensity of relationship with AC		
Audit methodology	IA operating manual	→	**Auditees satisfaction**
	IA role in CRSA		
	Definition and update of the audit plan		
	IA performance measurement system		
	Compliance with IIA standard		
	Internal auditors		
Individual	Technical skills		
	Behavioural skills		

Figure 1: Conceptual model

Characteristics of the IA units as a whole

The characteristics of the IA unit include (1) staff and position of the department and (2) audit methodology applied in the audit work.

A preliminary condition for internal audit to be able to do its duties is the availability of a large enough number of skilled professionals. The size of the IA team, one of the key criteria used by external auditors to evaluate its quality (see for instance Zain et al. 2006; Al-Twaijry et al., 2004, Felix et al., 2001), clearly determines the amount of time that internal auditors can dedicate to auditing activities. Besides, in a larger team, there could be a higher rotation of auditors which

could provide more objectiveness: Gul and Subramaniman (1994) showed that when auditors are more acquainted with auditees, they are less objective in the case of managerial conflicts.

The second issue is the intensity of relationship between IA, on the one hand, and AC and top management, on the other hand. The position of IA in an organization is bounded; it is a corporate unit that should have a large amount of autonomy and independence in order to perform its activities in a proper manner. The Attribute Standard 1110 of the International Standards for the Professional Practice of Internal Auditing (2004) states that "the chief audit executive should report to a level within the organization that allows the internal audit activity to accomplish its responsibilities". Therefore, a key decision about the organizational role of IA concerns its relationship with top management and audit committee (AC). Previous studies showed the importance of a functional reporting relationship with the board of directors or audit committee, and an administrative reporting relationship with the CEO and senior management (see, for instance, Sarens and DeBeelde, 2006; Goodwin&Yeo, 2001), however there is little evidence on whether an intensive relationship between the IAF and the board of directors, audit committee and senior management has a positive impact on IA effectiveness (Sarens, 2009). The interaction with the AC makes information exchange and data availability easier (mat Zain et al., 2006; Bishop et al., 2000; Raghunandan et al., 1998, Walker, 2004). The AC monitoring of IA could also help identify problems in IA itself and offer opportunities for improvement. If IA reports to the AC, its role within the organization is also reinforced and the communication of managerial problems to the top levels of the company is helped (Goodwin & Yeo, 2001; Braiotta, 1999).

The interaction with senior management is also important. The Practice Advisory 1110-2 recommends that the Chief Audit Executive (CAE) must have an administrative reporting relationship with top management to achieve appropriate support to accomplish IA everyday activities. On the one hand, top managers can support internal auditors in identifying high-risk areas by asking them to include certain processes in the audit plan. On the other hand, Christopher et al. (2009) have argued that too much involvement of senior management in the internal audit planning, could have a negative impact on the independence of the IA unit (Sarens, 2009).

The second characteristic that may determine IA effectiveness refers to the auditing methodology and auditing techniques used. Most existing studies that deal with auditing techniques do not tackle the impact these techniques have on the IA capacity to monitor and improve risk management and internal control processes (Sarens, 2009).

The specific techniques/ methodologies of auditing tackled in this research are:

- Level of standardization of IA activities and existence of an IA operating manual;
- Definition and updating of the audit plan;

- Role of internal auditors in CRSA;
- IA performance measurement and assessment (quality assessment, improvement programme, external quality assessment);
- IIA Standards for the Professional Practice of Internal Auditing.

Characteristics of the individual internal auditor

The second set of elements refers to the characteristics of individual internal auditors, with specific reference to their skills. At a general extent, internal auditors skills can be distinguished into two classes: cognitive and behavioural skills (Pickett, 2000). Cognitive skills include technical competences. Behavioural skills include communication and interpersonal ability. Both these skills can influence the quality perceived by the auditees significantly.

Technical skills ensure that the auditors are more able to provide advice to improve the internal control system (mat Zain et al., 2006; Brody et al., 1998), to complete audits, to find consistent solutions based on previous experiences and to deal with complex and conflicting situations (mat Zain et al., 2006; Flesher & Zanzig, 2000). Previous studies underlined that line managers often believe that internal auditors do not have enough knowledge to provide useful help (Griffiths, 1999; Van Peursem 2004; 2005) and, if this is the case, they do not take into account their advice, hence reducing the effectiveness of IA (Van Peursem 2004; 2005).

Behavioural skills are required by auditors to establish a sound relation with their auditees; interpersonal and communication skills facilitate the understanding of audit findings and the ability to accomplish their responsibilities effectively (for a review, see Smith, 2005).

Furthermore, auditors' competencies, both behavioural and cognitive can increase the effectiveness of the IA team by improving the recognition of their role within the organization.

Broader organizational environment

The final set of elements influencing IA effectiveness deal with the broader organizational environment: (1) regulatory context and (2) level of risk of the company.

The role of laws and regulations in relation to IA effectiveness is twofold: first laws and regulations shape internal audit activities. In particular in those settings where the attention to both internal controls and internal audit is recent organizations' approaches are not based on consolidated routines and their (re)action can be more strongly influenced by external pressures in a process of external conformance (DiMaggio and Powell, 1983; Meyer, 1994).

Second, in many cases the internal auditors act as a translator of the impinging regulatory framework. Therefore the need to comply with a specific regulation could indirectly influence managers' perceptions of IA work.

Finally, the risk environment might affect IA effectiveness again at two levels. First it can influence the activities performed by the internal auditors. The level of risk of business process is generally a relevant issue in informing the audit plan, therefore determining a higher focus on certain processes. Further, it could also favour the adoption of risk – based techniques by the internal auditors. Second, the risk environment can also influence the control environment, with specific reference to the level of consciousness of managers concerning risk related issues. In this, the auditees perception of the auditors themselves can be significantly affected.

RESEARCH METHOD

The empirical analysis bases on an embedded multiple case study, involving 12 Italian organizations form different industries and different normative context (the analysis tackled listed and non listed companies; financial and non financial service providers).

To investigate which factors can influence the quality perceived by managers, several units of analysis were addressed:

- Individuals (auditees and internal auditors);
- Internal audit department;
- Broader organizational and legal environment.

Information relating to factors influencing the quality perceived by the auditees is thus collected and analyzed by combining three different levels.

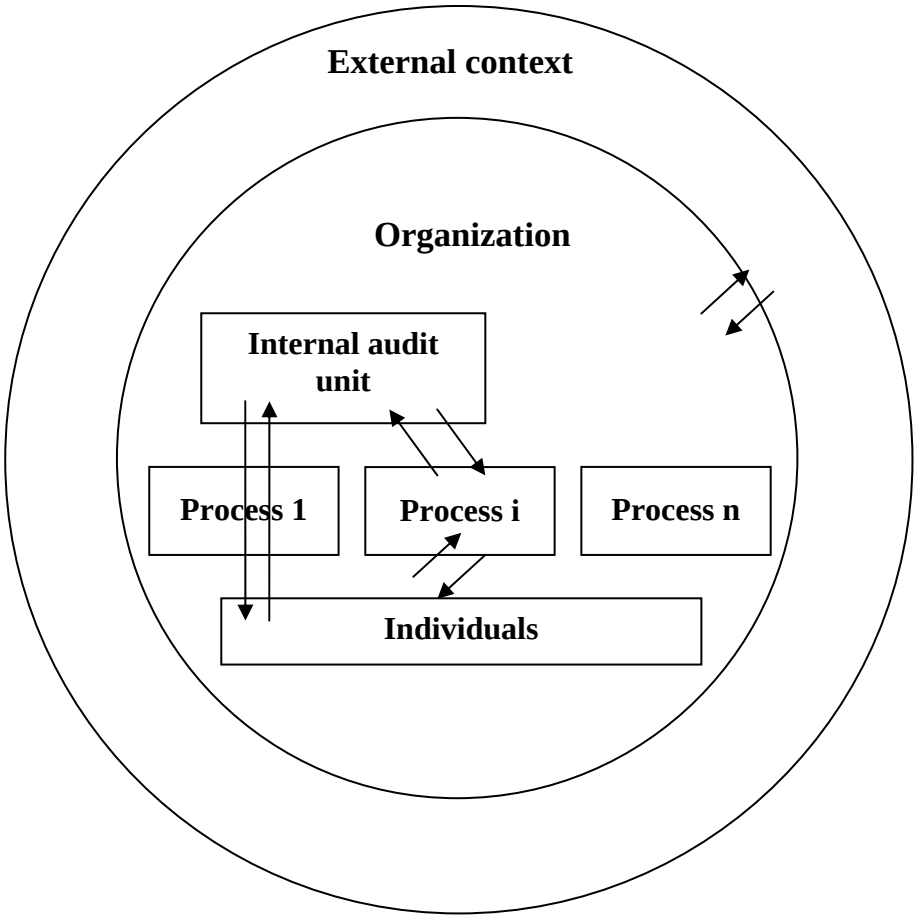

Figure 1: unit of analysis

Overall, 54 interviews were performed with different key informants (see table 1): both internal auditors and auditees were interviewed in each company. Interviews with the auditees supported the investigation of their perceptions over IA effectiveness; interviews with the IA team were essential to outline IA characteristics and activities in each case setting.

The interviews with the auditees were articulated into three parts, addressing: (1) role and responsibilities of the auditee in the broader organizational context, (2) interaction between internal auditors and auditees during the audit, (3) effects of internal auditing activities on processes under their responsibilities. The first part of the interview contributed in defining the context of the analysis, understanding roles and positions of the interviewed people. The second part tackled the modes of interaction between internal auditors and auditees during the audit processes. The third part aimed at understanding auditees' perception about internal auditors work, with reference to the impact on auditees' daily activities and the implementation of suggested actions.

The interviews with the internal auditors were critical to collect technical information about the characteristics of the IA unit and the individual internal auditor. They were articulated into three parts: (1) IA departments characteristics, (2) characteristics of individual auditors (3) activities carried out by internal auditors in the broader organizational environment. The first issue was

directed to support the researchers in identifying elements relevant for understanding the organization of the IA department. The second part of the interviews focused on the characteristics of the internal auditors with specific reference to competences and skills of the individual auditor and the audit team. The last part of the interview focused on the activities performed by internal auditors in order to gain a full picture of IA in each company.

Case	Listing	Size	Interviews
A	Yes (IT)	Between 1.000mln and 5.000mln euros	CAE Internal auditor Internal auditor Line manager Controller
B	Yes (US)	Between 5.000mln and 10.000mln euros	CAE Line manager Line manager
C	No	Between 1.000mln and 5.000mln euros	CAE Internal auditor Controller Line manager Plant manager
D	Yes (IT)	More then 10.000mln euros	CAE Internal auditor Controller Line manager
E	Yes (IT)	Between 500mln and 1.000mln euros	CAE Internal auditor Project manager CFO Line manager Controller
F	No	Between 100mln and 500mln euros	CAE Internal auditor Internal auditor CFO HR Line manager Line manager
G	Yes (IT)	Between 1.000mln and 5.000mln euros	CAE Line manager Controller
H	Yes (US)	Between 1.000mln and 5.000mln euros	CAE Internal auditor Line manager Line manager Project manager
I	No	Between 500mln and 1.000mln euros	CAE Internal auditor CFO Line manager
L	Yes (IT)	More then 10.000mln euros	CAE Internal auditor Line manager Line manager
M	Yes (US)	Between 1.000mln and 5.000mln euros	CAE Internal auditor CFO Line manager
N	Yes (US)	Between 5.000mln and 10.000mln euros	CAE Internal auditor Line manager Line manager

Table 1 - Interviews

FINDINGS

The companies analysed have been classified into four clusters, based on:

- The characteristics of the IA function;
- The level of auditees' satisfaction.

Figure 2 shows the positioning of the companies. The x-axis indicates the quality of IA function as measured by the factors previously discussed, and the y-axis shows the level of auditees' satisfaction. The two values divide the matrix into four quadrants, providing a visual indication of the patterns emerged in this research. The four quadrants are:

- Quadrant I, "Audit at surface": these companies are characterized by a low IA quality and a medium-high level of satisfaction of the auditees.
- Quadrant II, "Value audit": these companies are characterized by a high IA quality and a high level of satisfaction of the auditees;
- Quadrant III, "Decoupled audit": these companies are characterized by a high IA quality and a low level of satisfaction of the auditees;
- Quadrant IV, "Non value audit": these companies are characterized by a low IA quality and a low level of satisfaction of the auditees.

The positioning of different cases in each quadrant is not based on analytical procedures, but on a qualitative assessment of the two variables. As follows each quadrant is discussed in more detail.

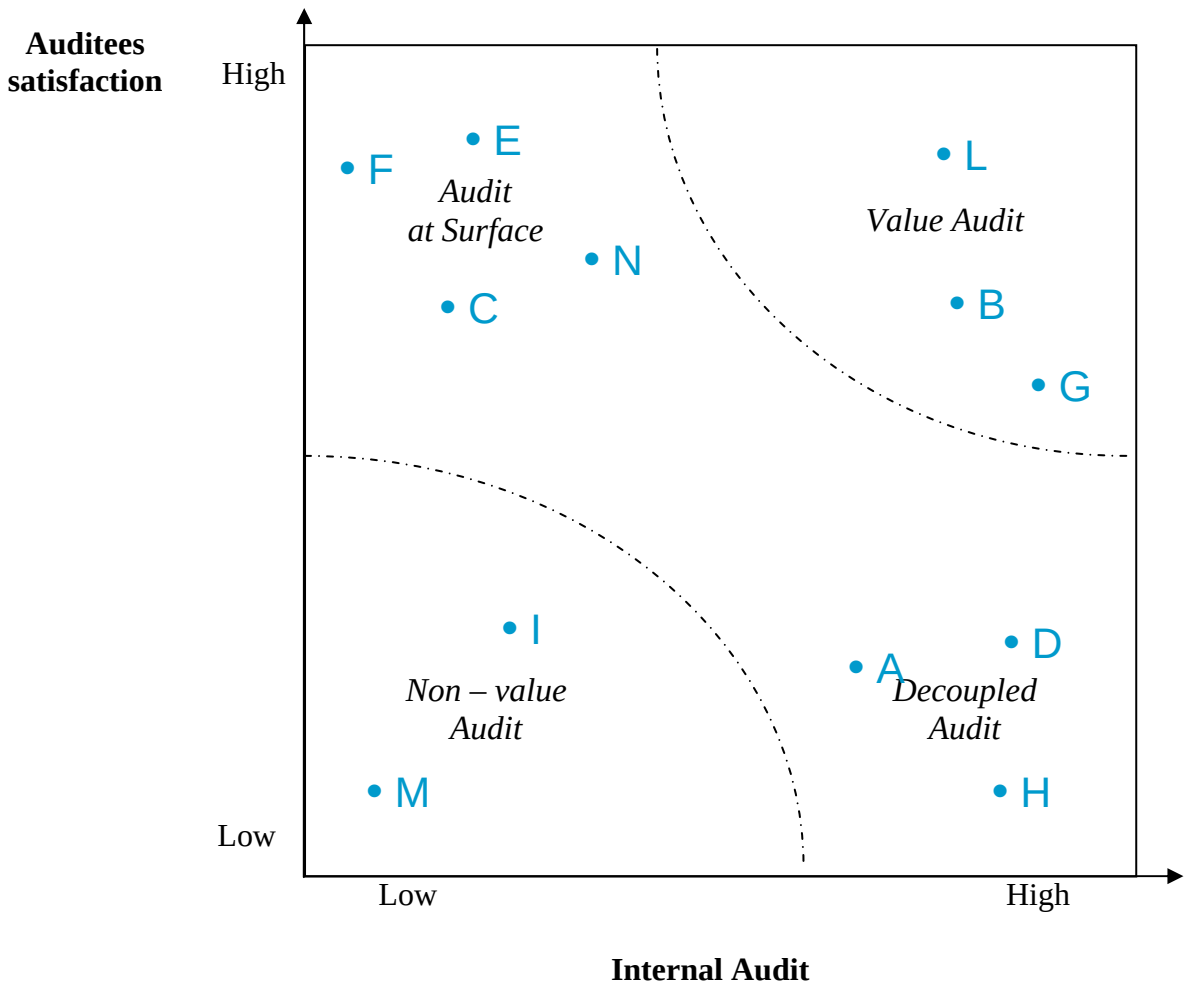

Figure 2: The emerging patterns

Audit at surface

This cluster includes four companies (C, E, F, N). In these companies, the auditees claimed to be quite satisfied of the audit activities, though the quality of the IA function appears fairly limited. Table 2 maps the main characteristics of the IA units included in this cluster.

The main limitations which can be highlighted in relation to these IA units relate to:

- Reporting line (in particular, to the AC);
- Audit methodologies applied; and
- IA competencies.

The relation with the AC appears critical. In F and C, there is no AC and also the interaction with the board of directors is fairly limited, mainly consisting in the IA preparing a yearly report. In N and I, there is the AC, which is formally in charge for the approval of the IA budget and the CAE takes part to the meeting of the AC (three / four times a year). However, the interviews highlighted

that the extent to which the AC actually enters in the IA activities is fairly limited, since the AC has never provided any feed-back on the audit plan or the IA work.

The audit methodologies applied do not appear particularly developed, as showed by the general lack of an IA operating manual, the limited diffusion of CRSA, the prevalence of a cycle based audit plan (though with the consideration of main risks), the lack of formal performance measurement tools and the low attention given to IIA standards.

Finally, the competencies of the IA units in these case settings, though quite diversified, present some common limitations.

- Though the auditors appear to have some competencies related to auditing, their knowledge of business processes is more limited. The recruiting policies of the three companies are relevant elements to explain this situation: in the three companies, most of new hired people are recruited immediately after the university (economics or law). In this way, the internal auditors have to develop competencies about business processes by auditing them, which actually limit, at least in the first stage of their career, their possible contribution to the improvement of business processes.
- Behavioural skills are recognized important by the CAE of the companies, but there is no formal training to improve such competencies.

Analysing the level of satisfaction of the auditees, we found that the interviewees were quite satisfied with the current situation, though for different reasons.

In company N and E, the drivers of auditees' satisfaction relate to the limited impact that IA has on the auditees activities. The following comment is paradigmatic of the attitude of the auditees in these cases:

> "It is ok, they have to do their work and I'd say that they do not cause particular problems, it is just for a few days a year, and not even each year" (*line manager at company E*)

IA is seen as a "necessary evil" and a limited effort put in auditing activities determines a high level of satisfaction of the auditees. In the two cases, the auditees were satisfied about IA activities because they had *no* impact on their business. In this respect, it is also important to note that the auditees received (and agreed on) few recommendations; however, when asked about their intention weather to implement them, one of the interviewees answered:

> "Yes, maybe I'm going to do something, but I don't know if this problem is really worth it. It is right that the internal auditing pointed out this issue, because I'm aware of it, but I have to think about weather to do anything" (*line manager at company N*)

The case of company F is different since here the IA unit performs audit interventions centred on monitoring compliance with company's procedures, through a check list approach. However, the

auditees appear satisfied with this situation. This company had been own by the state until few years ago, and the prevailing set of values is still focused to conformance with laws and procedures. The audit structures are in line with the set of values dominant in the organizations, which however mainly oriented to compliance.

Finally company C is again different, the satisfaction of the auditees was related to the frequent involvement of IA units in ad hoc analysis. For instance, the internal auditors perform a monthly analysis of transportation costs aimed at understanding if these costs are properly exploited. The IA received the mandate for this task by the CEO, who was particularly committed to this problem. In this situation, the internal auditor is looked at as a business analyst, producing ad hoc reports addressing costs variations and analysing the motivations at the basis of these variations. In this context answers to a specific requirement strictly related with the company's KPI, which is the need of keeping transportation costs under control and identifying and managing potential factors that could determine them rising. The auditees acknowledge the supporting role of the auditors in improving their business activities, because they are provided with information relevant for taking corrective actions or revising their policies.

> They [internal auditors] support our unit in monitoring transportation costs since the end of the 2004. They provide a punctual analysis of each variation. On a monthly basis, we receive a report with a monitoring of standard costs, actual costs and the outliers, in relation to which the internal auditors evidence specific problems that have determined an unexpected situation with certain transportation (*line manager at C*).

A further example related to the same case deals with the analysis of technical inventories, which are constituted by parts and spare components of machinery used for production. The level of these inventories has always been particularly high. Therefore, the auditing staff has been involved in a rationalization project aimed at limiting the working capital, where it was possible. The internal auditors' contribution here related mainly with an analysis of the level of inventories and supporting the identification of a reasonable trade off, between cost of maintenance and the risks of interrupting production processes. On the other hand, the IA unit do very few "audits". Only in the financial area, the IAs are engaged in some auditing activities.

[Please insert Table 2 about here]

Value audit

This cluster includes companies B, G and L. In these companies the auditees resulted quite satisfied about IA activities and the quality of the IA function appears quite good.

Table 3 synthesizes the characteristics of the IA function. Compared to the previous cluster, these companies have more developed IA units. First, the positioning of the IA units is generally in line with the international best practices (administrative reporting line to the CEO and functional reporting line to the AC). There is a frequent interaction with the CEO, in particular to comment and explain the results of the audit activities. Indicators related to major risky areas are included in the top managers reporting (Company L). Also the relation with the AC appears more intensive if compared to the previous cluster: besides the provision of regular reports to the AC and the participation of the CAE in the AC meetings, the AC gives the IA some feed-backs on the audit plan as well as the work actually performed.

Auditing activities are performed through a systemic approach, as suggested by the adoption of an operating manual, the higher relevance given to the IIA standards and the existence of formal performance measurement systems for IA activities, including both customer satisfaction surveys and well-defined sets of KPI, sometimes also agreed with the CEO and the AC. In two out of three companies, there is a formal management control system of the IA, with dedicated resources.

Finally the competencies of the internal auditors in these cases are pretty diversified. The key point is that they cover both business processes and auditing competencies. This is clear considering the presence of more certified internal auditors (CIA, CCSA, CFSA), the use of auditing standards in doing audits, but also the attention given by the CAE to the development of more technical competencies (for instance IT). Also the composition of the audit team is much more diversified in term of work experience.

The auditees apparently recognize the contribution of IA activities to their business at two levels: first the auditors can provide line managers with an external view on their processes; second the auditors can provide useful feedbacks and suggestions about risks and controls.

An example of the first situation is provided by company G. Here, the satisfaction of the interviewed auditees was related to the possibility of exploiting IA work to monitor their business activities. IA work was really considered adding value, since IA through audit interventions, answered to a managerial need.

> "I use them. I exploit them as far as I can. They can give me something I need for my business. (…) Otherwise I would have to employ my resources to control these issues". (*Head of BU, auditees at company G*).

A second example, which provides an evidence of the contribution of IA to the improvement of the audited processes is provided by company L. Here, the internal audit team has recently audited the activities associated to sponsorships, highlighting the lack of both formal procedures and indicators directed to monitor the results of each sponsorship. This situation was determined by the low level of formalization, characterizing this kind of activities; however, the analysis carried out by the

internal auditors pointed out the relevance of risks associated with the lack of procedures and performance indicators: not effective sponsorship programs and overlapping initiatives initiated by different units, and potential non-compliance risks with respect to an Italian law (231/01).

> "The audit highlighted the existence of some major risks in the process in place. The lack of formal procedures was determining confusion and inefficiency. The auditors supported my assistants in defining a correct procedure, which could be both time effective and flexible on the one hand, and in line with compliance requirements on the other hand. Now there are different units, which can initiate a sponsorship here; without a procedure and a system for monitoring these initiatives, diverse units could make overlapping actions".
>
> "The lack of formal performance indicators was actually a problem because the company is investing increasing resources in these kinds of activities; thus it is necessary to understand which initiatives are profitable, which are not producing the expected results" (*Auditee at L, Head of the Public relations*).

In this case the contribution of the internal auditors' to the improvement of the process can be explained by their competences and their "view" over business activities. The auditors looked at the sponsorship as a process, and this view allowed them to highlight potential risks, related to the whole process.

[Please insert Table 3 about here]

Decoupled audit

This cluster includes companies A, E and H. In these companies the auditees resulted not satisfied about IA activities, though the quality of the IA function appears quite good.

Table 4 synthesizes the characteristics of the IA function, which are very similar to the previous cluster. The companies included in this group have established advanced internal auditing units, with a systemic approach to internal auditing; they show wide competencies, and high attention to the used of advanced audit methodologies.

However, in these cases, the auditors do not appear able to communicate to the auditees the relevance of the activities performed. Here, internal auditing is considered mainly a *bureaucratic accomplishment*. The auditees do not recognize the contributions of internal auditors, though their attention focuses on key processes and riskiest areas.

Based on the auditees interviews, IA activities are seen as to increase bureaucratization in two ways; first, fostering the introduction of controls which are *not cost-effective*; second, in transforming the audit intervention itself in a *bureaucratic requirement*.

The first problem can arise in certain context, where the auditors are very oriented to controls over procedures, however, without considering the effects that these procedure can have on business

activities. Case D provides an example of this situation. Here, the auditor reviewed the planning process, giving particular attention to the risk analysis performed for supporting the plans' formulation. One of the major concerns of the auditor referred to the use of excel models for calculating risks associated to a specific scenery; this approach ensures limited possibility to verify the existence of errors in risk calculation.

> Ok, his point is true, if you do not know the file you can't understand whether there is an error in the formulas. However, there are not different solutions. It is complex to include controls in the excel file to verify that the formulas in the cells are correct or not. (*Auditee, Line manager at company D*)

The second problem relates mainly with the way in which the auditees consider the audit intervention, whether it is looked at as a bureaucratic fulfilment or something that may be useful for their processes. The auditors generally do not recognize this risk, because they see the objectives of their controls clearly and they are generally able to relate their intervention to specific corporate objectives. However, the situation is different for the auditees, which:

- may not recognize possible impacts from deviations from the procedures;
- may consider the procedures in place too stringent or not relevant, though aware of potential risks.

Both these circumstances could lead to the rejection of the auditors' recommendations, though factors determining this reaction are quite differentiated. The first situation generally relates to the lack of information flows from the auditors to the auditees (*communication*). Interviews in A and H pointed out the relevance of communicating the scope of the audit interventions clearly, highlighting potential problems and concrete consequences of risks impinging over a business area or a process. In this case, the bureaucratization risk relates more to how the audit signification is communicated then to the nature or the focus of the audit intervention.

[Please insert Table 4 about here]

Non Value audit

The last cluster includes companies I and M. In these companies the auditees resulted not satisfied about IA activities and the quality of the IA function appears limited.

These companies are characterized by low developed internal auditing units as well as a low level of satisfaction of the auditees. The audit approach is very "old style", focused mainly on monitoring and conformance to rules and procedures. And the audit activities here result in a low level of satisfaction of the auditees.

[Please insert Table 5 about here]

DISCUSSION AND CONCLUSION

The change of perspective, which has characterized internal auditing in the last decades, has focused increasing attention on issues such as value added, effectiveness and performance evaluation of internal auditing (for instance Dittenhofer, 2001; Bou-Raad, 2000; IIA, 1999). Researchers and practitioners have widely discussed over the need for internal auditors to adding more value to their companies operations, and contributing to the achievement of corporate objectives, through an active role in the risk management and corporate governance systems.

To answer to these expectations, the organizational profile of internal auditors should change accordingly and such new role should be recognized also by managers and officers in their organizations. This is a key point, since the internal auditors do not act on business activities or on the internal control-risk management system "directly". The internal auditors can identify a criticism or an area of potential improvement and provide managers, responsible of business processes, with an evaluation of the internal control–risk management systems. Managers and officers have to decide whether and how enacting internal auditors' recommendations. Therefore, in the end, the effect that internal auditors have on the achievement of corporate objectives is influenced by the extent to which managers exploit internal auditors' work. In such view, the relation between internal auditors and managers (auditees) becomes a critical issue. Therefore, this paper aims at analysing which factors can favour an effective relation between internal auditors and auditees and can enhance auditees' satisfaction over internal auditors' contribution.

The research method was based on a multiple case study, involving 12 Italian organizations form different industries and different normative context (the analysis tackled listed and non listed companies; financial and non financial service providers). Overall, 54 interviews were performed with different key informants: both internal auditors and auditees were interviewed in each company. Interviews with the internal audit team were essential to outline internal audit activities in each case setting; interviews with the auditees supported the investigation of their perceptions over internal audit effectiveness.

The analysis showed that different factors are important to drive IA effectiveness. However, not all of them are under internal auditors' control. Among controllable factors, the most relevant deal with competence and professional proficiency of internal auditors, an adequate "promotion" of internal audit at company level, and the modes of interaction between auditors and auditees during audit interventions. Instead, factors which are not completely under internal auditors' control include, on

the one hand, resources available to the audit function (budget and people of the audit team); on the other hand, the risk profile of the organization and its KPI.

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Table 2: Characteristics of IA units in cluster *Audit at surface*

		N	F	C	E
Organizational environment					
Firm	**Regulatory context**	Listed	Not listed	Not listed	Listed
	Level of risk of the industry / business	Low (regulated business)	Low (ex-public company)	Low (paper sector)	High (ICT)
Internal Audit units					
Staff and position	**Size**	IA unit was founded between five and ten years ago; 7 auditors; The number of IAs is expected to increase.	IA unit was founded about ten years ago; 27 auditors; The number of IAs is expected to increase.	There has always been an IA unit; 4 auditors; The number of IAs is stable.	There has always been an IA unit; 9 auditors; The number of IAs has been increased in the last years and it is expected to further increase
	Intensity of relationship with top management	The CAE reports to the CEO. The CEO receives written reports on a quarterly basis.	The CAE reports to the CEO. The CEO receives written reports on a quarterly basis.	The CAE reports to the CFO. The CAE also reports regularly to the CEO, who frequently assigns to the IA ad hoc tasks (for instance analysis of transportation costs; technical inventories monitoring)	The CAE reports administratively and functionally to the CEO. In defining the audit plan the CEO is used to require IA to audit certain areas of interest.
	Intensity of relationship with AC	The CAE reports to the AC; The IA provide the members of the AC with written reports about four times a year; The AC is not much involved in the activities of the IA.	There is no AC; The CAE does not report to the BoD;	There is no AC; The CAE does not report to the BoD;	The CAE reports to the AC; The IA provide the members of the AC with written reports about four times a year; The AC is not much involved in the activities of the IA.
Audit methodology	**IA operating manual**	There is an operating manual which has been issued by the parent company. The IA activities are pretty standardized	There is no operating manual.	There is no operating manual.	There is no operating manual.
	IA role in CRSA	IA has applied CRSA only once, because the parent company required all the controlled companies to do that. Afterwards, CRSA has not been applied any more.	No CRSA (the company is going to implement this technique)	No CRSA (the company is going to implement this technique)	CRSA is used to define the audit plan

	Definition and update of the audit plan	The audit plan is mainly cycle based. It covers a three year time period.	The audit plan is risk-based and covers a three year time period	There is an audit plan, which focuses on few business areas (financial). The audit plan is mainly cycle based, though it considers risks at some extent.	The audit plan is risk based. It covers a three year time period and it is revised on an annual basis.
	IA performance measurement system	No formal tools	No formal tools	No formal tools	There are no formal tool at present, but the CAE wish to introduce a customer satisfaction survey
	Compliance with IIA standard	IIA standards appear not so relevant. The CAE is aware of them, but they do not seem to be a priority.	IIA standards are not formally adopted, though the CAE recognize the relevance of using them.	IIA standards are not formally adopted, though the CAE recognize the relevance of using them.	IIA standards are not adopted and the CAE does not consider them a relevant issue.
Internal auditors					
Individual	**Beckground**	Most of the IA staff has a master degree in Economics; there is also a person with a master degree in Law.	The IAs have different academic backgrounds: economic, law, engineering. Most of the IAs currently employed in the IA unit have been hired after different work experiences. Only few auditors (generally covering the higher positions in the audit chart) started their career in auditing. At present, new IAs are hired through a stage after completing the university.	The IAs have similar academic backgrounds, having a MSc in economic and laws disciplines. There is almost no turnover in the IA unit: "IA is a work for a life". People hired in this function are supposed to make career in here.	The IA staff has mainly an economic background. One of the people of the staff is an ex-external auditor from UK. The CAE was hired in this company with the specific objective of introducing CRSA techniques, since he had a previous work experience, as CAE of a different company using this methodology.
	Competences / Technical skills	One IAs is certified (CIA); competence development is mainly pursued through the IIA training courses	3 auditors are certified CIA and 3 auditors are certified CCSA, 5 auditors have certifications related to quality systems.	One auditors has a four-year experience in external auditing. There are no other certifications.	There are no certified IAs, however 2 auditors are certified as external auditors.
	Behavioural skills	Behavioural skills are considered important by the CAE, but the auditors do not have any formal training	Behavioural skills are considered important by the CAE, but the auditors do not have any formal training	No formal training.	No formal training.

Table 3: Characteristics of IA units in cluster *Value audit*

		B	L	G
		Organizational environment		
Firm	**Regulatory context**	Listed	Listed	Listed
	Level of risk of the industry / business	High (Bank and Insurance)	High (Diversified company)	Medium (Media)
		Internal Audit units		
Staff and position	**Size**	There has always been an IA unit; About 360 auditors; The number of IAs is expected to remain stable, with an incidence of about 1% on the total number of employees.	There has always been an IA unit; 9 auditors at company level (24 at group level); The number of IAs is expected to increase.	The IA unit was established more than 10 years ago; 8 auditors; The number of IAs is expected to remain stable.
	Intensity of relationship with top management	The CAE reports administratively to the CEO. There is a frequent interaction between the CEO and the CAE to discuss the quality of the internal control system based on the audit findings. Compliance with regulation is a key issues and the CEO is particularly sensitive to this issue.	The CAE reports administratively to the CEO. There is a strong interaction between the CEO and the IA, which is mainly due to the role of IA in the RM process. The IA is required to provide the CEO with an evaluation of the more risky areas. A set of key risk indicators is developed by the IA and constantly monitored by top management (the company is also experimenting the development of an incentive system related to it)	The CAE reports administratively and functionally to the CEO. The CEO is provided with regular reports by the IA (on a quarterly basis). There is a strong interaction in particular with the CFO, who regularly requires some audit intervention on high risk processes.

	Intensity of relationship with AC	The IA reports functionally to the AC and the CAE participate in AC meetings (about four times a year); IA reports are directed to the members of the AC (five times a year). The AC reviews the audit plan and the work performed by the IA regularly. One of the main objective of the AC is to upraise IA performances	The CAE reports to the AC; The CAE meets the AC about two times a year; IA reports are directed to the members of the AC (four times a year) The AC reviews the audit plan and the audit findings The AC was specifically created to review the work performed by the IA	The IA provide the members of the AC with written reports about four times a year; The IA participate in AC meetings (about four times a year); The real interaction between AC and IA is not so strong. Though there is an exchange of information, the actual contribution of the AC to IA activities is not evident (they receive reports but normally they do not provide feed-backs)
Audit methodology	**IA operating manual**	Yes	Yes, it was formalized in the early years after the development of the IA unit to describe how the IA activity should be planned, reports format, frequency and receivers, audit procedures ad follow-up conduction.	Yes
	IA role in CRSA	CRSA are regularly applied. Furthermore, there is an integrated risk management system, which integrates different risk management areas (operational, financial, credit…). The outcome of this process are the input for the preparation of the audit plan.	There is CRSA and the IA has contributed to the development of the tool. However, the responsibility of the system is now passed to the Planning Unit	No
	Definition and update of the audit plan	The audit plan is risk based (inputs are provided by CRSA, risk management and previous audit findings).	The audit plan is risk based and covers a four years time period. However it is updated about once a year.	The audit plan is risk based. It covers a three year time period and it is revised on an annual basis.
	IA performance measurement system	Yes, quantitative approaches and customer satisfaction survey.	No formal tools	Yes. Customer satisfaction survey

	Compliance with IIA standard	IIA standards appear not so relevant. The CAE is aware of them, but they do not seem to be a priority	IIA standards appear not so relevant. The CAE is aware of them, but they do not seem to be a priority	No
		Internal auditors		
Individual	**Background**	The IAs have different academic background (economics, maths, statistics, IT and law). The recruiting policies are diversified: people are hired in the IA unit at different stages of their career: young analysis are hired immediately finished the university; more experienced people are hired after some work experience in the IA of other banks or external auditing firms. finally few people are dedicated to IA from other BU. Generally the upgrade of the IAs can take place in the IA unit of other banks of the group, or in other BU.	New IAs are generally recruited at university level (mainly with a degree in economic and law disciplines). After 4/5 years they move to the financial and administrative functions. Only four persons in the unit have been employed as IAs for longer periods (more than 8 years).	The IA staff has mainly an academic background in Economic and Law disciplines. The recruitment of IAs is diversified. The turnover rate is on average 6-8 years.
	Competences / Technical skills	Certifications are considered a relevant issue: several IAs are certified CIA or CFSA. IIA courses are one of the training methods, but the auditors are trained also through internal courses and seminars provided by other training centres.	There are four IAs with a CIA certificate and three of them have also the CCSA certificate. Apparently the IAs have more limited process experience (they are generally young people and have to develop such competence by auditing other units)	There are no IAs certified by the IIA . However, 2 auditors is certified as CPA.
	Behavioural skills	No formal training, though the CAE recognize that it is an important issue	No formal training, though the CAE recognize that it is an important issue	No formal training, though the CAE recognize that it is an important issue

Table 4: Characteristics of IA units in cluster *Decoupled audit*

		D	A	H
Organizational environment				
Firm	**Regulatory context**	Listed	Listed	The parent company is listed on the NYSE, the controlled company is not listed
	Level of risk of the industry / business	High (Energy)	High (Bank)	High (ICT)
Internal Audit units				
Staff and position	**Size**	IA unit was founded more than ten years ago; 17 auditors; The number of IAs is expected to increase.	IA unit was founded more than ten years ago; 400 auditors; The number of IAs has been recently increased of about 10%.	IA unit was founded more than ten years ago; 8 staffed in Italy and 200 staffed in the foreign parent company; The number of IAs is going to increase in the near future.
	Intensity of relationship with top management	The CAE reports administratively to the CEO. There is an intensive relation between IA and CEO: the CEO requires quite often the CAE to include specific issues in the audit plan, deepening on perceived risk areas. Reports to the CAE are realized on a monthly bases and there are regular meetings between them.	The CAE reports administratively to the CEO. Regular reports are directed to the CAE about the most relevant risk areas.	The CAE reports to the CFO, to whom the IA reports administratively. IA reports are regularly sent also to the CEO (each three months).
	Intensity of relationship with AC	The CAE reports functionally to the AC; The IA provide the members of the AC with written reports at least four times a year; The AC is actually involved in the activities of the IA (review of the audit plan, review of the audit reports, evaluation of IA performances).	There is no AC; The CAE does not report to the BoD.	There is no AC; The CAE does not report to the BoD.

Audit methodology	**IA operating manual**	There is an operating manual, issued eight years ago. The manual is kept update to include relevant changes in the auditing procedures. The IA activities are pretty standardized	There has always been an operating manual, to ensure the standardization of auditing procedures in the whole group, both in Italy and in other foreign companies of the group. This is considered an useful tool to ensure the training of new hired IAs.	The operating manual has been issued by the parent company, in order to standardized the audit intervention across the world. This manual is actually used for any intervention and is considered an useful tool for new - hired people.
	IA role in CRSA	The company has an enterprise risk management system in place. The IA has a monitoring role on it an it uses the output of the risk management process for the definition of the audit plan.	CRSA are used to assess the risk profile of the company and it is the bases for the definition of the audit plan.	The company has a risk and opportunity management system in place. The IA is responsible of assessing the quality of the methodology applied, through periodical audit on the system.
	Definition and update of the audit plan	The audit plan is risk based. The risk analysis is based on the output of the ERM system and on a risk map made by the IA (which considers also the results of previous audit activities and the specific inquiries of top managers and AC). The audit plan covers a 3 year time period.	The audit plan is risk based and covers a three years time period.	The audit plan is risk based and covers a four year time period. The audit plan of the local company os also integrated with the audit plan of the parent company, therefore "joint audit" are included in the plan.
	IA performance measurement system	A customer satisfaction survey has been recently introduced. Further, the CAE has a set of KPI he monitors to control the IA activity (these include timesheets analysis; training time; timeliness and quality of reports.	The performance evaluation is based on a set of KPI defined by the CAE (for instance the IA fte/overall fte, training, reports quality, budget, variances between audit performed and audit planned…). No customer satisfaction survey is used at the moment.	There are formal tool for the evaluation of the IA unit, which are mainly determined by the parent company (KPI). The auditors generally perform customer satisfaction survey.

	Compliance with IIA standard	The CAE claimed to require his team to apply the IIA standard, when performing audits. He considers this issue a relevant point for enhancing the professionalism of the IA unit.	IIA standards are considered relevant and they are generally adopted when auditing.	IIA standards are not adopted
		Internal auditors		
Individual	**Background**	Most of the IA staff has a master in Economics; however, there are few people with a degree in law and in technical disciplines. The IAs are employed here after different work experiences. The average turnover of the unit is about 6 years.	The IAs have different backgrounds: economic, law and maths are the main disciplines. The IAs can be employed in the unit at different point of their career.	The IAs have different backgrounds. The IAs can be employed in the unit at different point of their career: A person stays in this unit for about three years and then he moves to other business functions. Generally the IAs are not at their previous work experience but come from different units.
	Competences / Technical skills	Four IAs are certified (CIA) and three IAs are certified CCSA, furthermore 2 persons are CPA; Competence development is now strongly based on the IIA training courses	There are several CIA and CCSA. Furthermore, CFSA	The competences of the IAs are very focused on two issues: business processes (since they generally come from Bus). The only certifications held by auditors in the Italian company is external auditing (revisore).
	Behavioural skills	No formal training	No formal training	No formal training

Table 5: Characteristics of IA units in cluster *Non-value audit*

		I	M
Organizational environment			
Firm	**Regulatory context**	Listed	Not listed
	Level of risk of the industry / business	Medium - Low (Public services partly owned by PA)	High (Multinational highly diversified company)
Internal Audit units			
Staff and position	**Size**	There has always been a IA unit. 18 auditors; The number of IAs has been recently reduced.	There has always been an IA unit; 80 auditors; The number of IAs is not expected to increase.
	Intensity of relationship with top management	The CAE reports functionally to the CEO. The intensity of their relationship is not too strong. Reports are directed to the CEO on a quarterly basis.	The CAE reports to the CFO
	Intensity of relationship with AC	There is no AC; The CAE does not report functionally to the BoD, however, the CAE directs IA reports to the BoD quarterly.	There is no AC; The CAE does not report to the BoD.
Audit methodology	**IA operating manual**	There is no operating manual.	There is an operating manual which has been issued by the foreign parent company. The IA activities are pretty standardized
	IA role in CRSA	No CRSA	No CRSA (the company is trying to implementing it)
	Definition and update of the audit plan	The audit plan is mainly cycle based	Risk based
	IA performance measurement system	No formal tools	Customer satisfaction survey
	Compliance with IIA standard	IIA standards appear not so relevant. The CAE is aware of them, but they do not seem to be a priority	IIA standards are not adopted
Internal auditors			

Individual	**Background**	Most of the IA staff has a master in Economics; there is also a person with a master in Law	The IAs have different backgrounds. The economic and laws disciplines, but also engineering. The IAs can be employed in the unit at different point of their career: most of them have been hired through a stage after completing the university; other have higher work experience.
	Competences / Technical skills	One IAs is certified (CIA); competence development is mainly pursued through the IIA training courses	No certifications.
	Behavioural skills	No formal training	No formal training